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ABSTRACT

Information on potential tax-saving opportunities when planning a sabbatical is provided for college personnel. Advice is offered about tax savings for: rental of the academician's personal residences while away from home, the home office deduction, use of an auto, and foreign income tax exclusion. The answer to what expenses are deductible depends on the nature of the sabbatical and partly on how effectively sabbatical recipients plan their activities. Sabbaticals that involve travel away from home or an extended stay in a foreign country may produce a variety of expenses that qualify for tax deduction. In order to document properly the deductibility of the travel expenses, the taxpayer must demonstrate the business purpose of sabbatical travel and must follow recordkeeping requirements. Keeping a diary on a timely basis is also important. When renting one's home, it may be possible to realize substantial tax savings by showing a loss for tax purposes. Loss can be computed by subtracting house expenses from the rent received. Three requirements for making a tax deduction for a home office are that the office must be used exclusively and regularly for business, the home office must be the principal place of business, and the use of the home office must be for the convenience of the employer. (SW)

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PLANNING A SABBATICAL?
These Tips Can Save Taxes

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by
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In these days of financial stringency, sabbaticals may seem to be an endangered species. But these important attractions of academic life are still offered by most colleges and universities and are still widely sought by faculty.

Any academician planning a sabbatical should look carefully at the "after tax" costs of various sabbatical activities. The authors have found that, in many cases, income tax savings from taking a sabbatical are so extensive that, if properly understood, they can often make a difference in determining whether or not a sabbatical project is financially feasible.

Most academic salaries range between $20,000 and $50,000 per year. Assuming a family of four, this puts most academicians in the 18% to 38% tax bracket if only federal income taxes are considered. Since most states have an income tax, this means an even higher effective tax bracket. The higher one's tax bracket, the greater the potential tax savings available through various tax deductions. If you are in the 40% tax bracket, tax deductions save you 40 cents on the dollar; i.e. the government will effectively pay 40 percent of your deductible expenses.

The question arises, "What expenses are deductible?" The answer depends on the nature of the sabbatical and at least in part on how effectively the sabbatical recipient plans his or her activities. Although many typical sabbatical activities have the potential of yielding deductible expenses, proper planning and timely documentation is absolutely necessary to ward off potential challenge by the Internal Revenue Service.

Typical Sabbatical Activities

Most sabbatical activities revolve around scholarly research or professional development that may not be easily accomplished within the normal rigors of academic life. Frequently this means travel away from home and possibly an extended stay in a foreign country. Such a situation can produce a variety of expenses that qualify for tax deduction.

Section 162(a)(2) of the Internal Revenue Code provides that individuals who are away from their "tax home" on business overnight are entitled to deduct expenses for food, lodging, and transportation. A taxpayer's tax home is defined as the general area around his permanent place of employment. According to the IRS, extended stays in a new area do not result in a change in one's tax home as long as the stay is for a year or less.

It is important to remember that as long as an individual's tax home does not move to a new location, his stay in the new location is viewed as temporary and his living expenses in the new area will be considered deductible. Deductible living expenses include rent, utilities, laundry, and telephone. Also included are expenses related to commuting back and forth to the taxpayer's temporary job assignment once the taxpayer establishes that he is away from home overnight. In fact, the same rules that apply to the traveling salesman while away from home apply to professors and other academicians as long as the primary purpose of their trip is business. Many sabbatical participants may deduct their entire living expenses for up to a year as long as they meet the requirements outlined here.

In order to document properly the deductibility of these travel expenses, the taxpayer must be able to demonstrate the business purpose of the trip. An easy way to do this is to include detailed discussion of it in both the sabbatical proposal and the final sabbatical report. In fact, it is an excellent idea to write both these documents knowing that they may be needed as documentation for business travel in the event of a tax audit.

In addition to demonstrating the business purpose of sabbatical travel, one must follow the same tough record-keeping requirements that apply to all travel and entertainment expenses. Current regulations require that the taxpayer show receipts for all items over twenty-five dollars. Acceptable receipts are cancelled checks, invoices, and credit card receipts. For items under twenty-five dollars, entries may be recorded in a diary; remember to note dates and times.

The importance of keeping a diary on a timely basis cannot be overemphasized. In a recent court case, the entire year's expenses of a traveling salesman were disallowed because the court did not believe they were recorded each day. The court noted that the word "diary" contained in the law comes from the same Latin word as "daily." Since the diary submitted by the salesman was written with a uni-

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form slant and with a uniform color of ink, the court concluded the entries were not made on a timely basis and disallowed the taxpayer's expenses.

In many cases, academicians on sabbatical are accompanied by their dependents. Expenses attributable to dependents' travel are not deductible. A problem occurs in deciding which expenses are attributable to the person on sabbatical and which are attributable to dependents. Generally speaking, the deductible expenses include all those the academician would have incurred if he had traveled alone. This means the auto mileage expenses are completely deductible as long as the person on sabbatical is in the car. In addition, hotels, rents, utilities, and other expenses are deductible at the single occupancy rate. It is a good idea to document the costs of single accommodations whenever possible.

Rental of Your Home

Many academicians find it advisable and necessary to rent their personal residences while away from home. In some cases it may be possible to realize substantial tax savings through showing a loss for tax purposes. To compute the loss, subtract house expenses from the rent received. These include interest, taxes, insurance, utilities, maintenance, repairs, and depreciation. The observant reader will note that of these expenses, only interest and taxes are normally deductible when one occupies the house as a personal residence. The remaining expenses are deductible only when the taxpayer is dealing with his residence as rental property and only when the personal residence is rented for a period of *at least one year.*

The requirement that the rental arrangement last for at least a year is the result of a special section in the tax law that was passed by Congress a few years ago. Congress intended this section to eliminate taxpayers' ability to show rental losses on vacation homes. An unfortunate result of this law is that vacation homes are defined as any home occupied by the taxpayer or his family for more than fourteen days during a given year. These rules, unfortunately, apply to a taxpayer's principal residence if it is rented for less than a year. Academicians going on sabbatical may want to extend the rental period to at least one year to take advantage of the opportunity to show a tax loss on their rental arrangement. It may also be a good idea to consult with a tax adviser in advance to estimate the potential savings from the rental arrangement. In many cases they can be substantial.

The Home Office Deduction

Probably no topic of conversation during tax time gets more attention than that of the home office. Under current law, three requirements generally must be met before a tax deduction may be taken for an office in the home. First, the portion of the home used must be used exclusively and on a regular basis for business purposes. Secondly, the home office must be the taxpayer's principal place of business. Finally, the use of the home office must be for the convenience of the employer.

The first requirement is met by making sure that the home office is not used for other than business purposes. This means a den used for recreational as well as work purposes will not qualify. Only an office or portion of a room that has exclusive use as an office meets the first requirement.

The second requirement, that the office in the home must be the academician's principal place of business, presents the most difficulty for the average college professor or administrator. Although many professors and administrators do a substantial amount of work in a home office, the focus of their work activities revolves around the college classroom or other campus areas. Thus this requirement will stop most teachers and other university personnel from being able to deduct the home office during their normal working situation.

A number of circumstances, however, make sabbatical activities a departure from the normal work situation and in so doing may allow the individual to properly claim the home office deduction during the sabbatical. Many universities have unwritten and even written requirements that force those on sabbatical to surrender their offices during the sabbatical period. The purpose of such rules is to insure that those on sabbatical will be free of distractions and normal work commitments and therefore free to focus their efforts away from the campus and on their sabbatical projects. Under such circumstances, individuals may properly claim the home office during the sabbatical time period.

The third requirement, that the home office serve the convenience of the employer, requires that the employee demonstrate either that no office is provided or that the office provided is inadequate. In the situation described above, this third requirement would be met.

Use of an Auto

Another possible tax savings opportunity exists when the individual on sabbatical makes extensive use of his auto to perform sabbatical activities. This is often the case when the person on sabbatical makes trips for data gathering, visiting libraries, interviewing subjects, consulting with colleagues, taking courses, or other related activities. While "business use" does not include transportation to and from work, it does include travel to job sites away from the taxpayer's normal business lo-

cation. It also includes the cost of commuting between the taxpayer's temporary lodging and workplace, once the taxpayer is away from home on business. Thus a person on sabbatical who visits a new job location for a period of up to one year and who uses an auto to drive to and from the new location, will have a substantial amount of business usage during the sabbatical period. This business usage times 20.5 cents per mile for the first 15,000 miles may result in a rather large tax deduction and related tax savings.

Until recently, the deductible portion of auto expenses could be computed by either the standard mileage method just mentioned or by keeping track of all automobile expenses including depreciation. While the second method required more detailed recordkeeping, it generally yielded higher deductions, especially when newer automobiles were involved. Accelerated depreciation methods encouraged shrewd individuals to delay purchase of a new automobile until the sabbatical year when a high percentage of business use could be claimed and a large amount of depreciation taken.

Unfortunately, the Tax Reform Act of 1984 requires that taxpayers "recapture" depreciation when the business use of an automobile declines from one year to the next. This means taxpayers must pay back the government for the depreciation claimed in one year if the percentage use of the asset declines in a subsequent year. While a detailed discussion of depreciation recapture is beyond the scope of this article, suffice it to say that most taxpayers claiming business use of automobiles during a sabbatical will be limited to claiming 20.5 cents per mile for the first 15,000 miles. In addition there is no longer a substantial tax incentive to purchase a new automobile during a sabbatical year.

Foreign Income Tax Exclusion

A significant tax savings opportunity for those on sabbatical is the foreign income tax exclusion. If an individual on sabbatical meets the requirements of the law, it is possible to avoid U.S. income tax completely on all income earned by working outside the country. There are four requirements for qualification under the foreign income tax exclusion:

1. The income to be excluded must be for services performed. Income on investments will not qualify.
2. The income earned must be for services performed while the individual was either: 1) outside the U.S. for at least 330 days out of any period of 12 consecutive months; or b) a bona fide resident of a foreign country or countries for an uninterrupted period that includes a full calendar year.
3. The individual's tax home must be in the foreign country.
4. The individual claiming the exclusion may not be an employee of the United States government or one of its agencies, or paid from U.S. government funds.

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The first requirement, limiting the exclusion to income earned for services rendered, includes sabbatical salaries and fellowship awards paid to the person on sabbatical. It does not include items like pension distributions, interest, dividends, and alimony.

The second requirement allows two ways to qualify for the exclusion, either by passing the residency test or by being physically outside the United States for the required period of time. Individuals whose sabbatical project requires traveling to a number of foreign countries can qualify for the exclusion as long as they establish a tax home outside the United States for the required period of time. Presumably, one's passport could be used as a means of demonstrating where the taxpayer resided for various times during the year.

The third requirement refers to the location of the individual's tax home. The definition of one's tax home has the same meaning here as it does in the discussion of deductibility of travel expenses; it is the area around which the individual is permanently employed. According to IRS ruling 74-291, an individual's tax home moves to a new location when he or she is employed at a new location for a year or more. Thus, if the move to the sabbatical location is for a year or more, one's tax home would change and the third requirement would be met. Assuming the other requirements are met, one should be able to claim the foreign exclusion. If the tax home is not moved, then one will be able to deduct the temporary living expenses. In no case will an individual be able to both exclude the income and deduct temporary living expenses. This is the obvious intent of the third requirement. Taxpayers who are wary of the government's wording of the tax home location would do well to plan for either eventuality and keep good records and receipts should their stay be determined to be temporary.

The authors are comfortable in signing tax returns claiming the foreign income exclusion and have done so in the past. We do, however, warn that those claiming the exclusion should be prepared for a possible audit challenge. The government might argue that since sabbaticals in many universities can only be applied for every six years, the income received during a sabbatical is actually earned over the years served in the United States as an employee. This would appear to be easily refuted in situations where the granting institution requires approval of a sabbatical proposal outlining specific work to be performed and a formal report that the sabbatical work was accomplished. We again suggest that the sabbatical application and final report be prepared with this in mind.

We hope this article helps to alert people to potential tax-saving opportunities when planning a sabbatical. That should include tax planning as an important consideration.

In addition, the advice of competent tax counsel is essential, both before and after the fact. Such counsel can provide detailed advice about changes in the law, accumulating the necessary documentation, and preparing your return. ■